



Lockheed Martin and Industry Issues

***Army Contracting Symposium
July 12, 2006***

***Eleanor Spector
Vice President
Contracts***

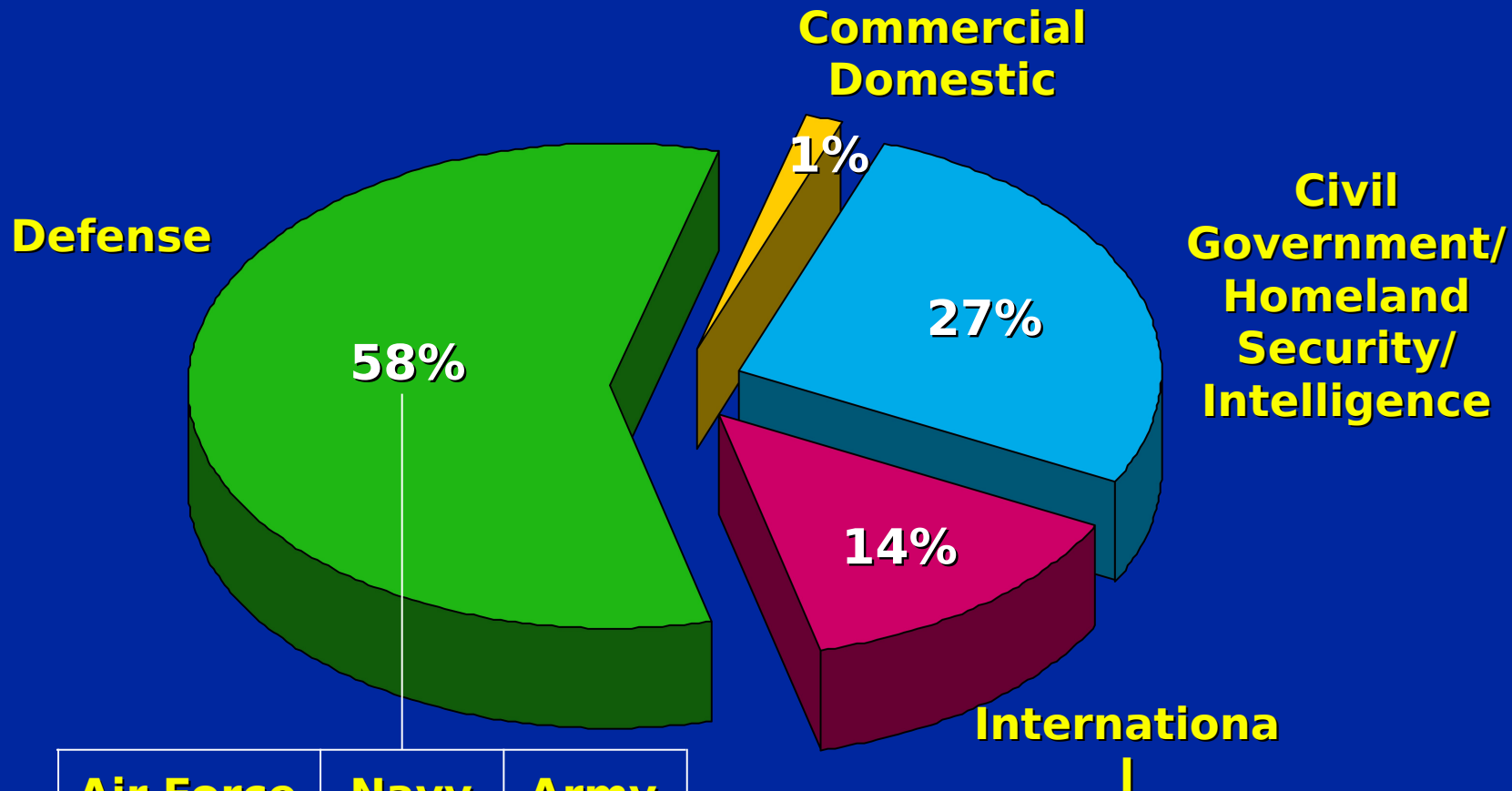
The Men and Women of Lockheed Martin



- **135,000 Employees**
- **60,000 Scientists and Engineers**
 - **20,000 IT Professionals**
- **Operations in 1,000 Facilities, 500 Cities, 45 States and 56 Countries**

Partners to Help Customers Meet Their Defining Moments

2005 Sales by Customer



Total Sales - \$37.2B

Major LM Army Programs



- **Patriot Advanced Capability 3 (PAC 3)**
- **Medium Extended Air Defense System (MEADS)**
- **Terminal High Altitude Air Defense (THAAD)**
- **Guided Multiple Launch Rocket System**
- **Javelin Antitank System**
- **Modernized Target Acquisition Designation Sensor (MTADS)**
- **Army Knowledge Online (AKO)**
- **WIN-T**
- **Information Technology Enterprise System (ITES)**
- **Warfighter Simulation (WARSIM)**
- **Virtual Convoy Tactical Trainer (VCTT)**
- **Future Tactical Truck**



Industry Economics

Stakeholder Expectations



- **Customers**
 - **Programs on time, on budget, with operational excellence, innovation**
- **Employees**
 - **“Employer of Choice”**
- **Debt holders**
 - **Repayment of debt with interest**
- **Shareholders**
 - **Return on Investment**

Must Balance Interests

Shareholder Expectations



- **Program performance and customer satisfaction**
- **Strong management team**
- **Recruitment and retention of the best people**
- **Ethical culture and corporate governance**
- **Consistent cash flow generation**
 - **Dividends**
 - **Debt reduction**
 - **Share repurchase**
 - **Acquisitions**
 - **Internal investment**

**Profit is Vital to the Survival of the Corporation
margins**

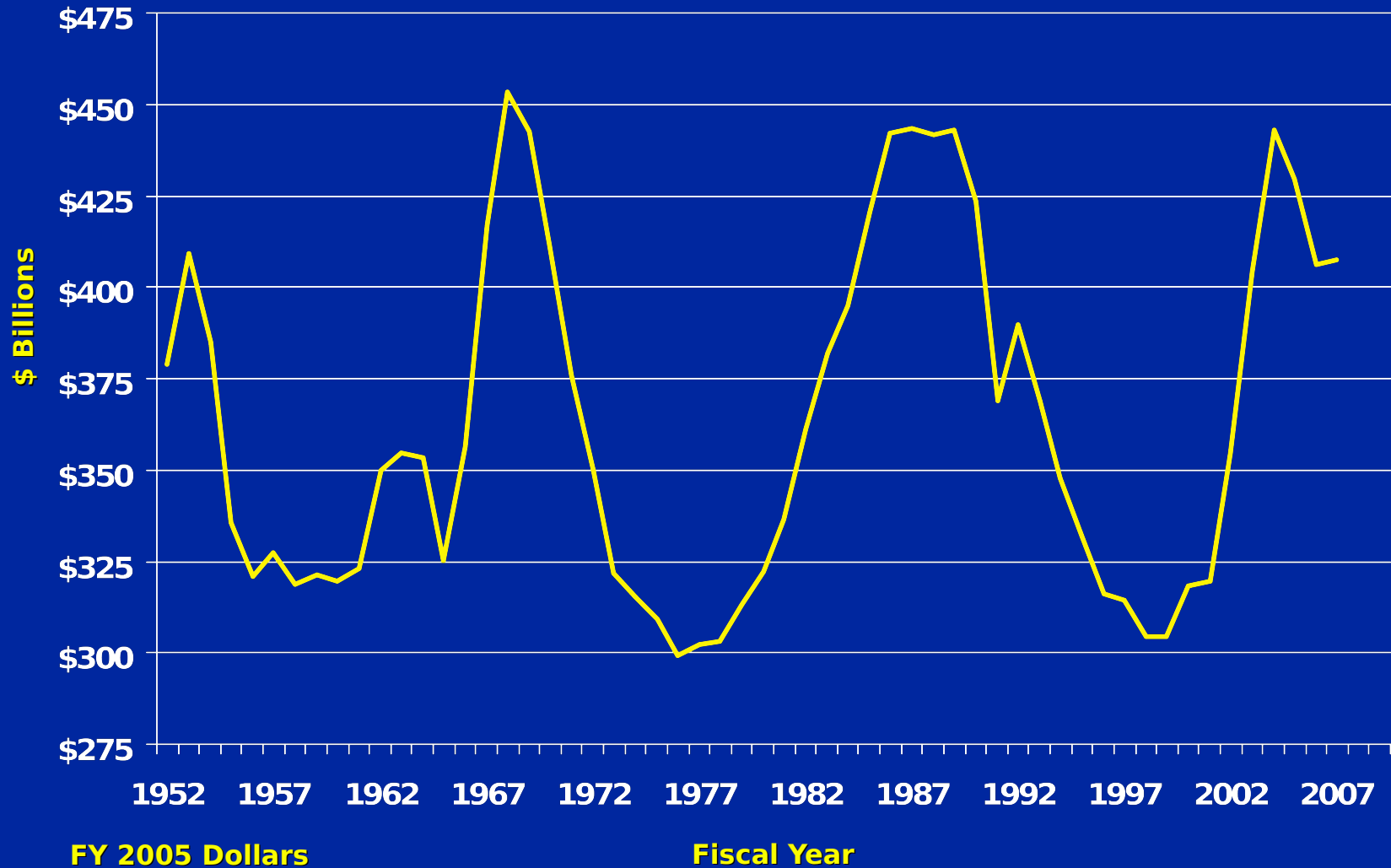


Business Risk in Our Market

- **Monopsony**
- **Program and Funding Instability**
- **Single Year Procurements**
- **Investment Requirements versus Recovery with Adequate Returns**
- **Program Performance**



Defense Outlays



Competitive Development



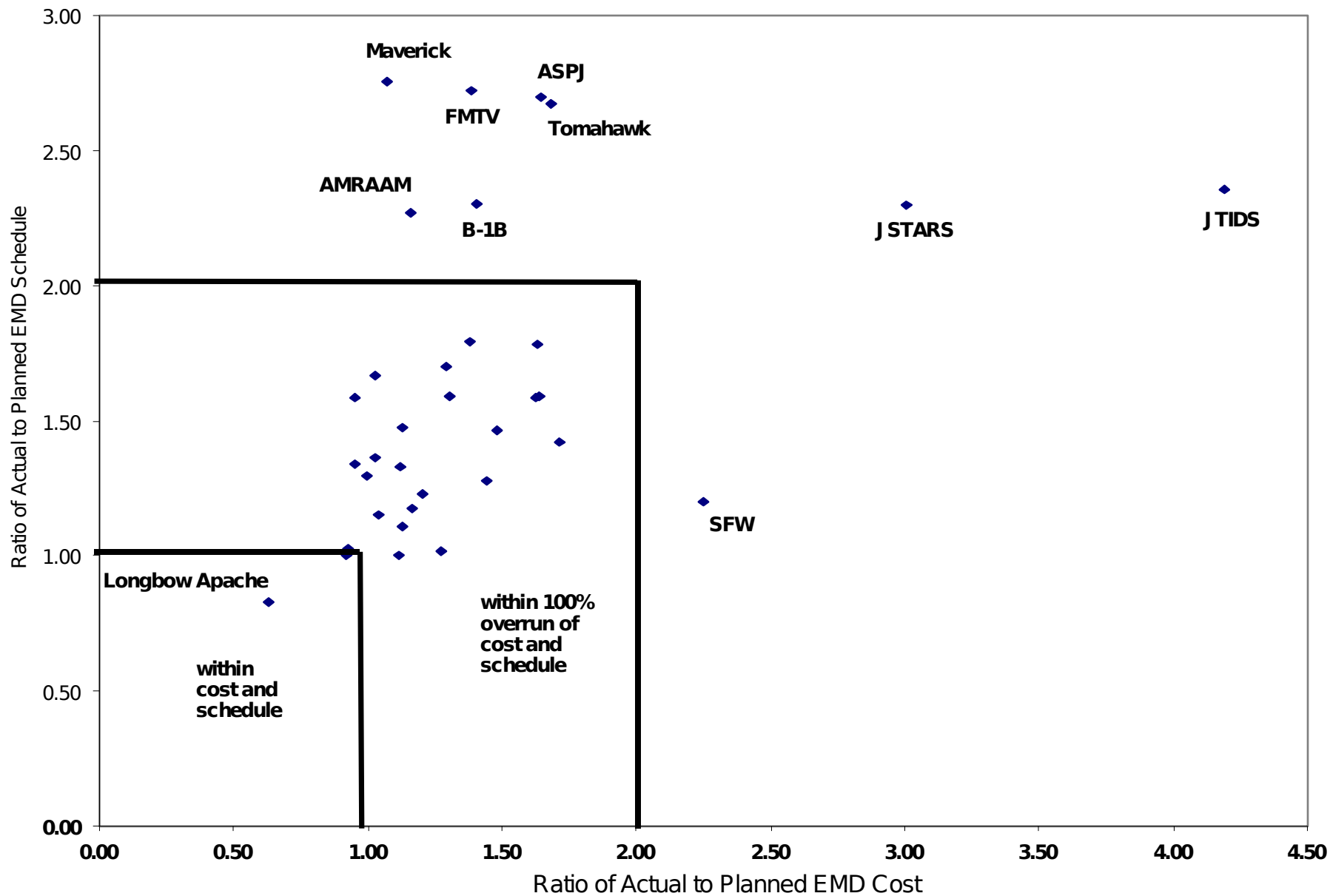
- **The lowest margins are on development programs where there is the greatest investment in facilities and equipment, and the need for the most highly skilled work force.**
- **Development is ~48% of DoD's procurement and R&D outlays.**
- **The Defense industry can no longer rely on production programs which produce higher margins.**
- **Lower margins in development, the high percentage of development programs, and the uncertainty of production, results in an uncertain outlook for Defense industry profitability.**

Root Causes of Overruns



- **Lack of technology maturity...
unknown/unknown technical challenges**
- **Uncontrolled requirements growth**
- **Program funding perturbations**
- **Unrealistic cost estimates**
 - **Optimistic budget estimates**
 - **Impact of competition on “price to win”**
- **No contingency funding in budgets or proposals**

Ratio of Actual to Planned EMD Cost and Schedule





Desired Government Actions

- **Use the appropriate type of contract**
- **Provide base fee routinely**
- **Provide provisional billing of award fee routinely**
- **Increase base and available award fees**
- **Permit fee rollover**
- **Use subjective criteria for award fees**
- **Prohibit profit takeback penalties**
- **Prohibit fixed priced options before major system design**

Within DoD Control



Desired Government Actions

- **Do not encourage or require contractors to supplement appropriations for R&D by:**
 - **Using IR&D to subsidize contract R&D**
 - **Establishing cost ceilings that in essence convert cost-type contracts into fixed-price contracts**
 - **Capping annual funding increments unreasonably on R&D contracts**
 - **Awarding contracts at prices that are known to be less than the probable cost of performance**

Economics Summary



- **Financially sound contractors are able to attract the resources and talent necessary to provide best value solutions to warfighters and taxpayers.**
- **Profit is vital to the survival of any industry including the defense industry.**
- **Contractors must be given the opportunity to earn fair profits.**



FY 2007 Defense Authorization Bill

Berry Amendment



- Since 1972, DoD aircraft, missile, ship, tank/automotive, weapon, and ammunition purchases must incorporate specialty metals reprocessed or produced in the U.S.
- 280+ suppliers of low value, dual use commercial parts (e.g, screws, springs, nuts, filters, washers, bolts) do not comply or are unable to verify compliance.
- Deliveries from suppliers have been impacted on programs including PAC - 3 and MLRS.
- Lockheed Martin seeking DNAD waiver on integrated circuits and semiconductors from the Army and the Air Force.

Impossibility of Performance in Supply Chain

Senate Warner Amendment



- **Exception to Berry Amendment for commercial items at any tier of the supply chain. “Commercial item” does not include an item that contains more than 5% non-commercial modifications.**
- **Provides *de minimis* exception allowing DoD acceptance of an item containing non-preferred specialty metals not exceeding 2% of the total amount of specialty metals in the item.**
- **Permits use of non-preferred specialty metals if the contractor certifies on**

Industry Strongly Supports

metals.

Fixed Price Development

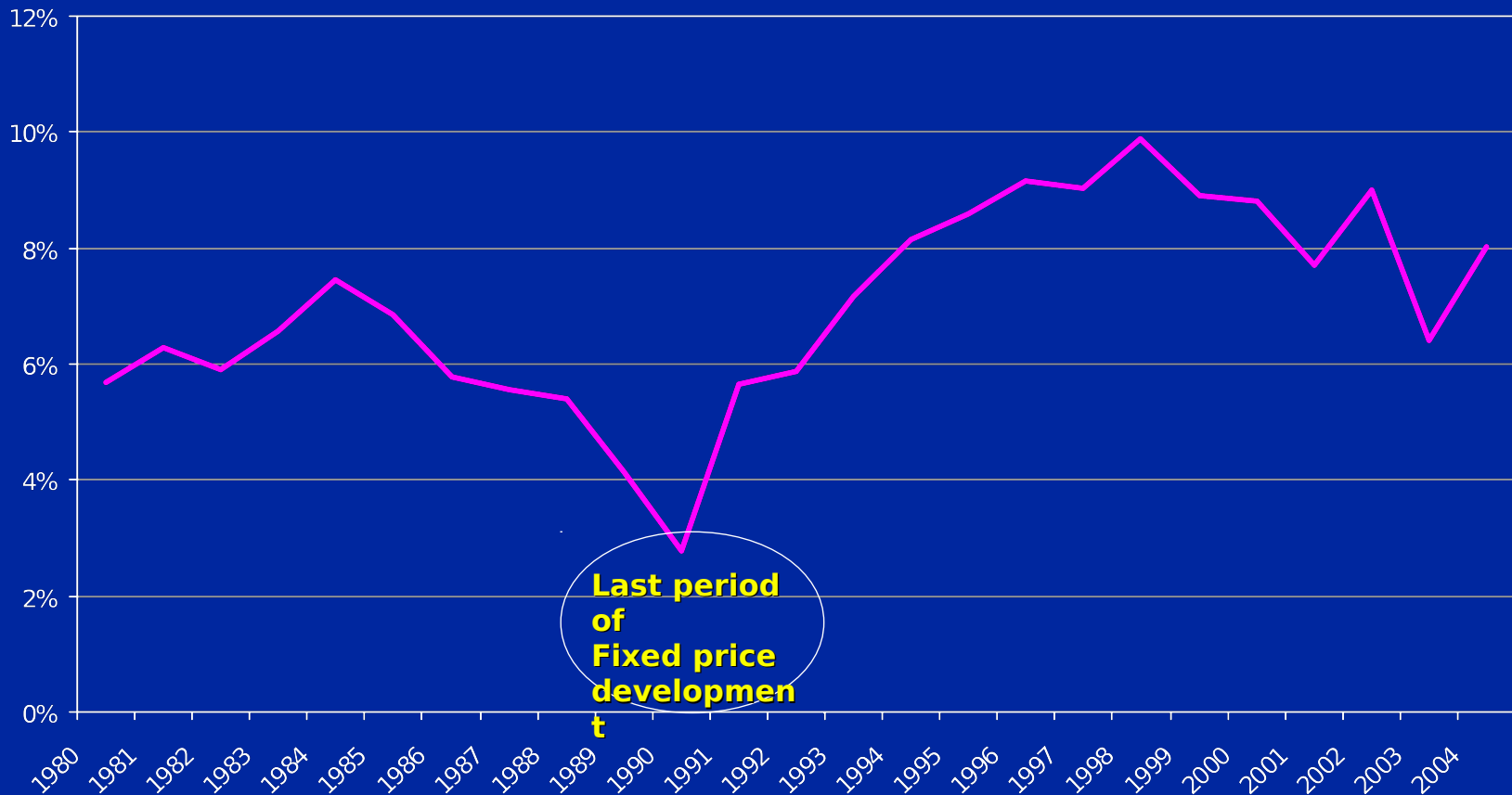


- **Preference for FP contracts for development, with waivers at the SECDEF level. Inappropriate use of FP contracts for development has never resulted in a successful program. The Statement of Administration Position opposes this section.**
- **There is hard evidence several fixed price development programs caused industry profits to decline substantially and resulted in the near bankruptcy of companies who had those contracts.**

Defense Industry Margins



CSIS Defense Index Average Operating Margin (weighted by revenue)



Note: CSIS Defense Index comprises 36 publicly-traded companies with majority revenues derived from US defense business. Boeing Military results have also been included.

Sources: FactSet, Company Reports, CSIS



Service Contract Manpower Reporting

January 2005 SecArmy Memo



Imposes burdensome reporting requirements to ensure that “contractor support” figures are included in Army manpower reports.

- Level of detail inconsistent with law that limits data to that available from contractor’s existing systems. Other Military Departments use existing information.**
- Applied beyond traditional services contracts (R&D, SDD, production), not just for contractor manpower typically performed by Army internal resources.**

Industry Position



- **Necessary information for compliance with statutory reporting requirement is available without this report.**
- **Should not be applied to design, manufacture or support of hardware deliveries.**
- **In December 2005, Aerospace Industries Association requested Army eliminate the reporting requirement. Notwithstanding follow-up requests, still awaiting response from ASA(M&RA).**

Summary



- **Your attendance at this conference is a positive indication that you seek to understand the major issues affecting the Government and Industry Contracting community.**
- **Reaching agreement on issues is easier when Government and Industry are well informed.**

